

LIFE TIME FITNESS INC
Form 10-Q
August 03, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2009

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File No. 001-32230

Life Time Fitness, Inc.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of
incorporation or organization)

41-1689746

(I.R.S. Employer
Identification No.)

**2902 Corporate Place
Chanhassen, Minnesota**

(Address of principal executive offices)

55317

(Zip Code)

Registrant's telephone number, including area code: **952-947-0000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the registrant's common stock as of July 20, 2009 was 41,265,085 common shares.

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

| | June 30, 2009 | December 31, 2008 |
|--|--------------------------|----------------------------------|
| | (Unaudited) | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 10,805 | \$ 10,829 |
| Accounts receivable, net | 3,681 | 6,114 |
| Inventories and center operating supplies | 14,420 | 14,632 |
| Prepaid expenses and other current assets | 16,359 | 10,994 |
| Deferred membership origination costs | 21,317 | 19,877 |
| Deferred income taxes | 2,090 | 1,365 |
| | | |
| Total current assets | 68,672 | 63,811 |
| PROPERTY AND EQUIPMENT, net | 1,517,206 | 1,515,957 |
| RESTRICTED CASH | 3,439 | 3,936 |
| DEFERRED MEMBERSHIP ORIGINATION COSTS | 13,115 | 14,210 |
| OTHER ASSETS | 49,918 | 49,789 |
| | | |
| TOTAL ASSETS | \$ 1,652,350 | \$ 1,647,703 |
| | | |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| CURRENT LIABILITIES: | | |
| Current maturities of long-term debt | \$ 11,945 | \$ 10,335 |
| Accounts payable | 15,690 | 14,842 |
| Construction accounts payable | 22,223 | 63,418 |
| Accrued expenses | 55,526 | 46,230 |
| Deferred revenue | 41,123 | 36,098 |
| | | |
| Total current liabilities | 146,507 | 170,923 |
| LONG-TERM DEBT, net of current portion | 695,401 | 702,569 |
| DEFERRED RENT LIABILITY | 27,882 | 27,925 |
| DEFERRED INCOME TAXES | 50,079 | 51,982 |
| DEFERRED REVENUE | 12,143 | 13,719 |
| OTHER LIABILITIES | 28,817 | 27,684 |
| | | |
| Total liabilities | 960,829 | 994,802 |
| | | |
| COMMITMENTS AND CONTINGENCIES (Note 6) | | |
| SHAREHOLDERS EQUITY: | | |
| Undesignated preferred stock, 10,000,000 shares authorized; none issued or outstanding | | |

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Common stock, \$.02 par value, 75,000,000 and 50,000,000 shares authorized, respectively; 41,265,085 and 39,612,775 shares issued and outstanding, respectively

| | | |
|---|--------------|--------------|
| | 825 | 793 |
| Additional paid-in capital | 389,462 | 385,095 |
| Retained earnings | 305,085 | 271,711 |
| Accumulated other comprehensive loss | (3,851) | (4,698) |
| Total shareholders equity | 691,521 | 652,901 |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | \$ 1,652,350 | \$ 1,647,703 |

See notes to unaudited consolidated financial statements.

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|------------------|--|------------------|
| | 2009 | 2008 | 2009 | 2008 |
| REVENUE: | | | | |
| Membership dues | \$ 142,841 | \$ 126,121 | \$ 280,238 | \$ 245,769 |
| Enrollment fees | 6,540 | 6,640 | 13,013 | 13,173 |
| In-center revenue | 60,250 | 55,969 | 119,552 | 111,234 |
| Total center revenue | 209,631 | 188,730 | 412,803 | 370,176 |
| Other revenue | 2,918 | 3,677 | 6,180 | 6,682 |
| Total revenue | 212,549 | 192,407 | 418,983 | 376,858 |
| OPERATING EXPENSES: | | | | |
| Center operations | 128,871 | 113,259 | 255,845 | 220,839 |
| Advertising and marketing | 6,091 | 6,823 | 14,389 | 16,321 |
| General and administrative | 11,795 | 10,582 | 23,503 | 21,254 |
| Other operating | 4,887 | 4,675 | 9,774 | 8,770 |
| Depreciation and amortization | 22,635 | 17,190 | 44,699 | 33,780 |
| Total operating expenses | 174,279 | 152,529 | 348,210 | 300,964 |
| Income from operations | 38,270 | 39,878 | 70,773 | 75,894 |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense, net of interest income of \$23, \$17, \$162 and \$88, respectively | (7,880) | (6,905) | (15,354) | (14,116) |
| Equity in earnings of affiliate | 332 | 326 | 669 | 649 |
| Total other income (expense) | (7,548) | (6,579) | (14,685) | (13,467) |
| INCOME BEFORE INCOME TAXES | 30,722 | 33,299 | 56,088 | 62,427 |
| PROVISION FOR INCOME TAXES | 12,462 | 13,471 | 22,714 | 25,195 |
| NET INCOME | \$ 18,260 | \$ 19,828 | \$ 33,374 | \$ 37,232 |
| BASIC EARNINGS PER COMMON SHARE | \$ 0.46 | \$ 0.51 | \$ 0.85 | \$ 0.96 |
| DILUTED EARNINGS PER COMMON SHARE | \$ 0.46 | \$ 0.50 | \$ 0.85 | \$ 0.95 |
| | 39,285 | 38,963 | 39,167 | 38,923 |

WEIGHTED AVERAGE NUMBER OF
COMMON SHARES OUTSTANDING BASIC

WEIGHTED AVERAGE NUMBER OF
COMMON SHARES OUTSTANDING
DILUTED

39,763

39,325

39,475

39,372

See notes to unaudited consolidated financial statements.

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | For the Six Months Ended | |
|---|---------------------------------|-------------|
| | June 30, | |
| | 2009 | 2008 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 33,374 | \$ 37,232 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 44,699 | 33,780 |
| Deferred income taxes | (421) | 8,874 |
| Provision for doubtful accounts | 279 | 27 |
| Loss on disposal of property and equipment, net | 560 | 1,335 |
| Gain on sale of land held for sale | (873) | |
| Amortization of deferred financing costs | 1,301 | 571 |
| Share-based compensation | 4,027 | 3,895 |
| Excess tax benefit related to share-based payment arrangements | | (5) |
| Equity in earnings of affiliate | (669) | (654) |
| Changes in operating assets and liabilities | 14,245 | 20,555 |
| Other | 1,762 | 50 |
| Net cash provided by operating activities | 98,284 | 105,660 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (91,725) | (235,577) |
| Proceeds from sale of property and equipment | 8 | 365 |
| Proceeds from sale of land held for sale | 1,327 | |
| Proceeds from property insurance settlements | | 270 |
| Increase in other assets | (921) | (12,140) |
| Decrease (increase) in restricted cash | 497 | (2,234) |
| Net cash used in investing activities | (90,814) | (249,316) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from long-term borrowings | 7,812 | 38,538 |
| Repayments of long-term borrowings | (7,978) | (10,588) |
| Proceeds from (repayments of) revolving credit facility, net | (6,800) | 116,200 |
| Increase in deferred financing costs | (721) | (3,641) |
| Excess tax benefit related to share-based payment arrangements | | 5 |
| Proceeds from stock option exercises | 193 | 1,462 |
| Net cash provided by (used in) financing activities | (7,494) | 141,976 |

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| | | | |
|---------------------------------------|---------------------|-----------|----------|
| DECREASE IN CASH AND CASH EQUIVALENTS | | (24) | (1,680) |
| CASH AND CASH EQUIVALENTS | Beginning of period | 10,829 | 5,354 |
| CASH AND CASH EQUIVALENTS | End of period | \$ 10,805 | \$ 3,674 |

See notes to unaudited consolidated financial statements.

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Table amounts in thousands, except share and per share data)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary to fairly present financial position, results of operations and cash flows for the periods have been included.

These interim consolidated financial statements and the related notes should be read in conjunction with the annual consolidated financial statements and notes included in the latest Form 10-K, as filed with the Securities and Exchange Commission (SEC), which includes audited consolidated financial statements for the three fiscal years ended December 31, 2008. We evaluated the impact of events occurring after June 30, 2009 up to August 3, 2009, which is the date of issuance of these consolidated financial statements. These statements contain all necessary adjustments and disclosures resulting from that evaluation.

2. Share-Based Compensation

We have four share-based compensation plans, the FCA, Ltd. 1996 Stock Option Plan (the 1996 Plan), the Life Time Fitness, Inc. 1998 Stock Option Plan (the 1998 Plan), the Amended and Restated Life Time Fitness, Inc. 2004 Long-Term Incentive Plan (the 2004 Plan) and an Employee Stock Purchase Plan (the ESPP), collectively, the share-based compensation plans. In connection with approval for the 2004 Plan, our Board of Directors approved a resolution to cease making additional grants under the 1996 Plan and the 1998 Plan. The types of awards that may be granted under the 2004 Plan include incentive and non-qualified options to purchase shares of common stock, stock appreciation rights, restricted shares, restricted share units, performance awards and other types of share-based awards.

As of June 30, 2009, we had granted a total of 5,587,165 options to purchase common stock under all of the share-based compensation plans, of which options to purchase 950,528 shares were outstanding, and a total of 2,525,837 restricted shares were granted, of which 1,985,071 restricted shares were outstanding and unvested. We use the term restricted shares to define nonvested shares granted to employees and non-employee directors, whereas Statement of Financial Accounting Standards No. 123, Share-Based Payment (SFAS 123(R)) reserves that term for fully vested and outstanding shares whose sale is contractually or governmentally prohibited for a specified period of time.

Total share-based compensation expense included in our consolidated statements of operations for the three and six months ended June 30, 2009 and 2008, was as follows:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|-------------|--|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| Share-based compensation expense related to stock options | \$ 91 | \$ 617 | \$ 632 | \$ 1,319 |
| Share-based compensation expense related to restricted shares | 1,672 | 1,458 | 3,335 | 2,508 |
| Share-based compensation expense related to ESPP | 30 | 38 | 60 | 68 |
| Total share-based compensation expense | \$ 1,793 | \$ 2,113 | \$ 4,027 | \$ 3,895 |

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Table amounts in thousands, except share and per share data)

The following table summarizes the stock option transactions for the three month periods ended March 31, 2009 and June 30, 2009:

| | Stock Options | Weighted- Average Exercise Price | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|---|--------------------------|---|---|--|
| Outstanding at December 31, 2008 | 980,929 | \$ 21.65 | 5.6 | |
| Granted | | | | |
| Exercised | | | | |
| Canceled | (2,354) | \$ 31.06 | | |
| Outstanding at March 31, 2009 | 978,575 | \$ 21.63 | 5.4 | \$ 632 |
| Granted | | | | |
| Exercised | (24,100) | \$ 8.00 | | |
| Canceled | (3,947) | \$ 29.85 | | |
| Outstanding at June 30, 2009 | 950,528 | \$ 21.94 | 5.2 | \$ 2,439 |
| Vested or Expected to Vest at June 30, 2009 | 947,263 | \$ 21.88 | 5.2 | \$ 2,439 |
| Exercisable at June 30, 2009 | 918,831 | \$ 21.30 | 5.1 | \$ 2,439 |

No options were granted during the six months ended June 30, 2009 or the six months ended June 30, 2008. As of June 30, 2009, there was \$0.2 million of unrecognized compensation expense related to stock options that is expected to be recognized over a weighted average period of 0.4 years.

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between our closing stock price at June 30, 2009 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders, had all option holders exercised their options on June 30, 2009. This amount changes based on the fair market value of our stock. Total intrinsic value of options exercised during the six months ended June 30, 2009 and 2008 was \$0.3 million and \$1.5 million, respectively.

Net cash proceeds from the exercise of stock options were \$0.2 million and \$1.5 million for the six months ended June 30, 2009, and 2008, respectively. The actual income tax benefit realized from stock option exercises total \$0 and less than \$0.1 million, respectively, for those same periods.

The following table summarizes the unvested restricted shares activity for the three month periods ended March 31, 2009 and June 30, 2009:

| | Restricted Shares | Range of Market Price Per Share on Grant Date |
|----------------------------------|------------------------------|--|
| Outstanding at December 31, 2008 | 487,203 | \$ 14.31-53.95 |
| Granted | 657,315 | \$ 9.72 |
| Canceled | (2,253) | \$ 14.31-49.06 |

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| | | |
|-------------------------------|-----------|----------------|
| Vested | (100,136) | \$ 14.31-53.95 |
| Outstanding at March 31, 2009 | 1,042,129 | \$ 9.72-53.95 |
| Granted | 1,028,514 | \$ 16.39-20.44 |
| Canceled | (50,366) | \$ 9.72-50.82 |
| Vested | (35,206) | \$ 14.31-50.82 |
| Outstanding at June 30, 2009 | 1,985,071 | \$ 9.72-53.95 |

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Table amounts in thousands, except share and per share data)

During the six months ended June 30, 2009 and 2008, we issued 1,685,829 and 388,675 shares of restricted stock, respectively, with an aggregate fair value of \$27.3 million and \$10.6 million, respectively. The grant date fair market value of restricted shares that vested during the six months ended June 30, 2009 was \$5.1 million. The total value of each restricted stock grant, based on the fair market value of the stock on the date of grant, is amortized to compensation expense on a straight-line basis over the related vesting period.

In June 2009, the Compensation Committee of our Board of Directors approved the grant of 996,000 shares of long-term performance-based restricted stock to serve as an incentive to our senior management team to achieve certain diluted earnings per share (EPS) targets in 2011 and 2012. If a specified EPS target is achieved for fiscal 2011, 50% of the restricted shares will vest. If a higher EPS target is achieved for fiscal 2011, 100% of the restricted shares will vest. If the grant has not fully vested after fiscal 2011, 50% of the shares will vest if a specified EPS target is achieved for fiscal 2012. If none of the shares vested after fiscal 2011, 100% of the shares will vest if a higher EPS target is achieved for fiscal 2012. In the event that we do not achieve the required EPS targets, the restricted stock will be forfeited. A maximum of \$20.4 million could be recognized as compensation expense under this grant if all EPS targets are met.

We consider the specific EPS targets to be competitively sensitive information during the performance period. We believe these targets, inclusive of compensation expense under this grant, to be aggressive goals in excess of our current baseline expectations, and therefore, we did not recognize any compensation expense associated with the grant during the six months ended June 30, 2009. If the targets had been considered probable at June 30, 2009, we would have recognized \$0.3 million of compensation cost during the six months ended June 30, 2009. If it becomes probable that certain of the EPS performance targets will be achieved, the corresponding estimated cost of the grant will be recorded as compensation expense over the performance period. The probability of reaching the targets will be reevaluated each reporting period. If it becomes probable that certain of the target performance levels will be achieved, a cumulative adjustment will be recorded and future compensation expense will increase based on the currently projected performance levels. If we later determine that it is not probable that the minimum EPS performance threshold for the grants will be met, no further compensation cost will be recognized and any previously recognized compensation cost will be reversed.

Our ESPP provides for the sale of our common stock to our employees at discounted purchase prices. The cost per share under this plan is 90% of the fair market value of our common stock on the last day of the purchase period, as defined. The current purchase period for employees under the ESPP began July 1, 2009 and ends December 31, 2009. Compensation expense under the ESPP is estimated based on the discount of 10% at the end of the purchase period. In June 2006, our Board of Directors authorized the repurchase of 500,000 shares of our common stock from time to time in the open market or otherwise for the primary purpose of offsetting the dilutive effect of shares pursuant to our ESPP. During the first six months of 2009, we repurchased 43,274 shares for approximately \$0.6 million. As of June 30, 2009, there were 399,382 remaining shares authorized to be repurchased for this purpose. The shares repurchased to date have been purchased in the open market and, upon repurchase, became authorized, but unissued shares of our common stock.

3. Earnings per Share

Basic EPS is computed by dividing net income applicable to common shareholders by the weighted average number of shares of common stock outstanding for each period. Diluted EPS is computed based on the weighted-average number of common shares and common equivalent shares. Common equivalent shares represent the effect of dilutive stock options and restricted stock awards during each period presented. Stock options excluded from the calculation of diluted EPS because the option exercise or award price was greater than the average market price of the common share were 754,003 and 83,851 for the six months ended June 30, 2009 and 2008, respectively. Long-term performance-based restricted shares excluded from the calculation of diluted EPS because vesting of the shares was not probable were 996,000 and 0 for the six months ended June 30, 2009 and 2008, respectively.

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Table amounts in thousands, except share and per share data)

The basic and diluted earnings per share calculations are shown below:

| | For the Three Months | | For the Six Months | |
|--|-----------------------------|-------------|---------------------------|-------------|
| | Ended June 30, | | Ended June 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Net income | \$ 18,260 | \$ 19,828 | \$ 33,374 | \$ 37,232 |
| Weighted average number of common shares outstanding basic | 39,285 | 38,963 | 39,167 | 38,923 |
| Effect of dilutive stock options | 85 | 264 | 74 | 274 |
| Effect of dilutive restricted stock awards | 393 | 98 | 234 | 175 |
| Weighted average number of common shares outstanding diluted | 39,763 | 39,325 | 39,475 | 39,372 |
| Basic earnings per common share | \$ 0.46 | \$ 0.51 | \$ 0.85 | \$ 0.96 |
| Diluted earnings per common share | \$ 0.46 | \$ 0.50 | \$ 0.85 | \$ 0.95 |

4. Operating Segments

Our operations are conducted mainly through our large, multi-use sports, fitness and family recreation centers. We aggregate the activities of our centers and other ancillary products and services into one reportable segment as none of the centers or other ancillary products or services meet the quantitative thresholds for separate disclosure under SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. Each of the centers has similar expected economic characteristics, service and product offerings, customers and design. Each of the other ancillary products and services either directly or indirectly, through advertising or branding, complement the operations of the centers. Our chief operating decision maker uses EBITDA, which consists of net income plus interest expense, net, provision for income taxes and depreciation and amortization, as the primary measure of operating segment performance.

The following table presents revenue for the three and six months ended June 30, 2009 and 2008:

| | For the Three Months | | For the Six Months | |
|-------------------|-----------------------------|-------------|---------------------------|-------------|
| | Ended June 30, | | Ended June 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Membership dues | \$ 142,841 | \$ 126,121 | \$ 280,238 | \$ 245,769 |
| Enrollment fees | 6,540 | 6,640 | 13,013 | 13,173 |
| Personal training | 27,997 | 26,568 | 57,139 | 55,149 |
| Other in-center | 32,253 | 29,401 | 62,413 | 56,085 |
| Other | 2,918 | 3,677 | 6,180 | 6,682 |
| Total revenue | \$ 212,549 | \$ 192,407 | \$ 418,983 | \$ 376,858 |

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Table amounts in thousands, except share and per share data)

5. Supplementary Cash Flow Information

Decreases (increases) in operating assets and increases (decreases) in operating liabilities are as follows:

| | For the Six Months Ended June 30, | |
|---|--|---------------|
| | 2009 | 2008 |
| Accounts receivable | \$ 2,154 | \$ 648 |
| Income tax receivable | | 5,819 |
| Inventories and center operating supplies | 212 | 126 |
| Prepaid expenses and other current assets | (1,616) | (1,981) |
| Deferred membership origination costs | (346) | (3,375) |
| Other assets | (1,598) | |
| Accounts payable | 1,631 | 861 |
| Accrued expenses | 9,266 | 10,684 |
| Deferred revenue | 3,450 | 6,598 |
| Deferred rent liability | (43) | 903 |
| Other liabilities | 1,135 | 272 |
| Changes in operating assets and liabilities | \$ 14,245 | \$ 20,555 |

We made cash payments for income taxes of \$20.5 million and \$3.9 million for the six months ended June 30, 2009 and 2008, respectively. This \$16.6 million increase was primarily due to tax payment timing and the level of bonus depreciation deduction available. The first half of 2008 benefited from a \$5.8 million 2007 tax receivable which was applied to 2008 estimated tax and also benefited from bonus depreciation deductions created by the large volume of 2008 asset additions.

We made cash payments for interest of \$14.4 million and \$13.3 million for the six months ended June 30, 2009 and 2008, respectively. Capitalized interest was \$1.9 million and \$4.7 million for the six months ended June 30, 2009 and 2008, respectively.

Construction accounts payable and accounts payable related to property and equipment was \$22.9 million at June 30, 2009 and \$77.8 million at June 30, 2008.

6. Commitments and Contingencies

Litigation We are engaged in proceedings incidental to the normal course of business. Due to their nature, such legal proceedings involve inherent uncertainties, including but not limited to, court rulings, negotiations between affected parties and governmental intervention. We have established reserves for matters that are probable and estimable in amounts we believe are adequate to cover reasonable adverse judgments not covered by insurance. Based upon the information available to us and discussions with legal counsel, it is our opinion that the outcome of the various legal actions and claims that are incidental to our business will not have a material adverse impact on the consolidated financial position, results of operations or cash flows; however, such matters are subject to many uncertainties, and the outcome of individual matters are not predictable with assurance.

7. Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued FASB No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* a replacement of FASB Statement No. 162 (SFAS 168). SFAS 168 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP in the United States. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009.

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Table amounts in thousands, except share and per share data)

In May 2009, the FASB issued FASB No. 165, *Subsequent Events* (SFAS 165), which establishes general standards of accounting and disclosure for events that occur after the balance sheet date but before financial statements are issued. The accounting guidance contained in SFAS 165 is consistent with the auditing literature widely used for accounting and disclosure of subsequent events, however, SFAS 165 requires an entity to disclose the date through which subsequent events have been evaluated. SFAS 165 was effective for interim and annual periods ending after June 15, 2009. The adoption of SFAS 165 did not have a material impact on our consolidated financial statements.

In April 2009, FASB issued FASB Staff Position SFAS 107-1 (FSP SFAS 107-1) and Accounting Principles Board Opinion 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (APB 28-1). FSP SFAS 107-1 and APB 28-1 require disclosures about fair value of financial instruments whenever summarized financial information for interim reporting periods is presented. Entities shall disclose the methods and significant assumptions used to estimate the fair value of financial instruments and shall describe changes in methods and significant assumptions, if any, during the period. FSP SFAS 107-1 and APB 28-1 became effective for our interim reporting period ended June 30, 2009. See Note 9, Fair Value Measurements, for our disclosures required under FSP SFAS 107-1 and APB 28-1. In April 2009, the FASB issued FSP SFAS 157-4, which provides additional guidance for estimating fair value in accordance with SFAS No. 157, *Fair Value Measurements* (FSP SFAS 157-4), when the volume and level of market activity for the asset or liability have significantly decreased. FSP SFAS 157-4 emphasizes that even if there has been a significant decrease in the volume and level of market activity for the asset or liability and regardless of the valuation techniques used, the objective of a fair value measurement remains the same. In addition, the statement provides guidance on identifying circumstances that indicate a transaction is not orderly. FSP SFAS 157-4 became effective for our interim period ended June 30, 2009. The adoption of FSP SFAS 157-4 did not have a material impact on our consolidated financial statements.

8. Derivative Instruments

Effective January 1, 2009, we adopted Statement of Financial Accounting Standards No. 161, *Disclosures About Derivative Instruments and Hedging Activities – an amendment of SFAS No. 133* (SFAS 161), which requires additional disclosures regarding why we use derivative instruments, the volume of our derivative activities, the fair value amounts recorded to the consolidated balance sheet for derivatives and the gains and losses on derivative instruments included in the consolidated statements of operations.

As part of our risk management program, we may periodically use interest rate swaps to manage known market exposures. Terms of derivative instruments are structured to match the terms of the risk being managed and are generally held to maturity.

In 2007, we entered into an interest rate swap contract that effectively fixed the rates paid on a total of \$125.0 million of variable rate borrowings at 4.825% plus the applicable spread (which depends on our cash flow leverage ratio) until October 2010. In May 2009, we amended the interest swap contract to effectively fix the rates paid on the \$125.0 million of variable rate borrowings at 4.715% plus the applicable spread from July 2009 until October 2010. The contract has been designated a cash flow hedge against interest rate volatility. In accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, changes in the fair market value of the swap contract are recorded in accumulated other comprehensive income (loss). As of June 30, 2009, the \$3.9 million fair market value loss, net of tax, of the swap contract was recorded as accumulated other comprehensive loss in the shareholders equity section of our consolidated balance sheets and the \$6.2 million gross fair market value of the swap contract was included in long-term debt.

On an ongoing basis, we assess whether the interest rate swap used in this hedging transaction is highly effective in offsetting changes in the fair value or cash flow of the hedged item by comparing the current terms of the swap and the debt to assure they continue to coincide and through an evaluation of the continued ability of the counterparty to the swap to honor its obligations under the swap. If it is determined that the derivative is not highly effective as a hedge or hedge accounting is discontinued, any change in fair value of the derivative since the last date at which it was determined to be effective would be recognized in earnings.

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LIFE TIME FITNESS, INC. AND SUBSIDIARIES
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(Table amounts in thousands, except share and per share data)

9. Fair Value Measurements

Effective for the interim reporting period ended June 30, 2009, we adopted FSP SFAS 107-1 and APB 28-1, which require disclosures about fair value of financial instruments whenever summarized financial information for interim reporting periods is presented. The carrying amounts related to cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value due to the relatively short maturities of such instruments.

The fair value of our long-term debt and capital leases are estimated based on estimated current rates for debt with similar terms and the same remaining maturities. The fair value estimates presented are based on information available to us as of June 30, 2009. These fair value estimates have not been comprehensively revalued for purposes of these consolidated financial statements since that date, and current estimates of fair values may differ significantly.

The following table presents the carrying value and the estimated fair value of long-term debt as of June 30, 2009:

| | June 30, 2009 | |
|----------------------------------|-------------------|-------------------------|
| | Carrying Value | Estimated Fair Value |
| Fixed-rate debt | \$ 365,361 | \$ 340,547 |
| Obligations under capital leases | 19,173 | 18,969 |
| Floating-rate debt | 322,812 | 299,749 |
| Total | \$ 707,346 | \$ 659,265 |

SFAS 157 established a framework for measuring fair value and expanded disclosures about fair value measurements. The adoption of SFAS 157 had no impact on our financial position or results of operations. SFAS 157 applies to all assets and liabilities that are measured and reported on a fair value basis. This enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The statement requires that each asset and liability carried at fair value be classified into one of the following categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

We determined the fair value of the swap contract based upon current fair values as quoted by recognized dealers. As prescribed by SFAS 157, we recognize the fair value of the swap liability as a Level 2 valuation.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

The following discussion may contain forward-looking statements regarding us and our business, prospects and results of operations that are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described under **Risk Factors** in our Annual Report on Form 10-K for the year ended December 31, 2008. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC that advise interested parties of the risks and factors that may affect our business.

The interim consolidated financial statements filed on this Form 10-Q and the discussions contained herein should be read in conjunction with the annual consolidated financial statements and notes included in the latest Form 10-K, as

filed with the SEC, which includes audited consolidated financial statements for the three fiscal years ended December 31, 2008.

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Overview

We operate large, multi-use sports, fitness and family recreation centers. As of July 31, 2009, we operated 84 centers primarily in residential locations across 19 states under the LIFE TIME FITNESS brand.

We compare the results of our centers based on how long the centers have been open at the most recent measurement period. We include a center for comparable center revenue purposes beginning on the first day of the thirteenth full calendar month of the center's operation, prior to which time we refer to the center as a new center. We include an acquired center for comparable center revenue purposes beginning on the first day of the thirteenth full calendar month after we assumed the center's operations.

As we grow our presence in existing markets by opening new centers, we expect to attract some memberships away from our other existing centers already in those markets, reducing revenue and initially lowering the memberships of those existing centers. In addition, as a result of new center openings in existing markets, and because older centers will represent an increasing proportion of our center base over time, our comparable center revenue may be lower in future periods than in the past. Of the three new centers we opened in 2009, two are in existing markets. We do not expect that operating costs of our planned new centers will be significantly higher than centers opened in the past, and we also do not expect that the planned increase in the number of centers will have a material adverse effect on the overall financial condition or results of operations of existing centers.

Another result of opening new centers or leasing centers, is that our center operating margins may be lower than they have been historically. We expect both the addition of pre-opening expenses and the lower revenue volumes characteristic of newly-opened centers, as well as the occupancy costs associated with leased centers, to affect our center operating margins at these centers and on a consolidated basis.

If the economy remains slow, we also may experience increased member attrition, lower average dues, lower in-center revenue per membership as well as higher membership acquisition costs which may result in lower total revenue and operating profit in affected centers and on a consolidated basis. Our categories of new centers and existing centers do not include the center owned by Bloomingdale, LLC because it is accounted for as an investment in an unconsolidated affiliate and is not consolidated in our financial statements.

We measure performance using such key operating statistics as member satisfaction ratings, return on investment, average revenue per membership, including membership dues and enrollment fees, average in-center revenue per membership and center operating expenses, with an emphasis on payroll and occupancy costs, as a percentage of sales and comparable center revenue growth. We use center revenue and EBITDA margins to evaluate overall performance and profitability on an individual center basis. In addition, we focus on several membership statistics on a center-level and system-wide basis. These metrics include change in center membership levels and growth of system-wide memberships, percentage center membership to target capacity, center membership usage, center membership mix among individual, couple and family memberships and center attrition rates. During 2008, our attrition rate increased, driven primarily by inactive members leaving earlier than in the past. Our trailing twelve month attrition rate decreased slightly during the second quarter of 2009 from the first quarter 2009.

We have three primary sources of revenue.

First, our largest source of revenue is membership dues (66.9% of total revenue for the six months ended June 30, 2009) and enrollment fees (3.1% of total revenue for the six months ended June 30, 2009) paid by our members. We recognize revenue from monthly membership dues in the month to which they pertain. We recognize revenue from enrollment fees over the expected average life of the membership, which we estimate to be 30 months for the first and second quarters of 2009 and the fourth quarter of 2008, 33 months for the second and third quarters of 2008 and 36 months for the first quarter of 2008 and prior periods.

Second, we generate revenue within a center, which we refer to as in-center revenue, or in-center businesses (28.5% of total revenue for the six months ended June 30, 2009), including fees for personal training, registered dieticians, group fitness training and other member activities, sales of products at our LifeCafe, sales of products and services offered at our LifeSpa, tennis programs and renting space in certain of our centers.

Third, we have expanded the LIFE TIME FITNESS brand into other wellness-related offerings that generate revenue, which we refer to as other revenue, or corporate businesses (1.5% of total revenue for the six months ended June 30, 2009), including our media, wellness and athletic events businesses.

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Our primary media offering is our magazine, *Experience Life*. Other revenue also includes two restaurants in the Minneapolis market and rental income from our Highland Park, Minnesota office building.

Center operations expenses consist primarily of salary, commissions, payroll taxes, benefits, rent, real estate taxes and other occupancy costs, utilities, repairs and maintenance, supplies, administrative support and communications to operate our centers. Advertising and marketing expenses consist of our marketing department costs and media and advertising costs to support center membership levels, in-center businesses and our corporate businesses. General and administrative expenses include costs relating to our centralized support functions, such as accounting, information systems, procurement, real estate and development and member relations. Our other operating expenses include the costs associated with our media, athletic events and nutritional product businesses, two restaurants and other corporate expenses, as well as gains or losses on our dispositions of assets. Our total operating expenses may vary from period to period depending on the number of new centers opened during that period, the number of centers engaged in presale activities and the performance of our in-center businesses.

Our primary capital expenditures relate to the construction of new centers and updating and maintaining our existing centers. The land acquisition, construction and equipment costs for a current model center can vary considerably based on variability in land cost and the cost of construction labor, as well as whether or not a tennis area is included or whether or not we expand the gymnasium or add other facilities. We perform maintenance and make improvements on our centers and equipment throughout each year. We conduct a more thorough remodeling project at each center approximately every four to six years.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S., or GAAP, requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Ultimate results could differ from those estimates. In recording transactions and balances resulting from business operations, we use estimates based on the best information available. We use estimates for such items as depreciable lives, volatility factors, expected lives and rate of return in determining fair value of option grants, probability of achieving performance targets, tax provisions and provisions for uncollectible receivables. We also use estimates for calculating the amortization period for deferred enrollment fee revenue and associated direct costs, which are based on the historical average expected life of center memberships. We revise the recorded estimates when better information is available, facts change or we can determine actual amounts. These revisions can affect operating results.

Our critical accounting policies and use of estimates are discussed in and should be read in conjunction with the annual consolidated financial statements and notes included in the latest Form 10-K, as filed with the SEC, which includes audited consolidated financial statements for our three fiscal years ended December 31, 2008.

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The following table sets forth our statement of operations data as a percentage of total revenue and also sets forth other financial and operating data:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|--------------|--|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| Revenue | | | | |
| Center revenue | | | | |
| Membership dues | 67.2% | 65.5% | 66.9% | 65.2% |
| Enrollment fees | 3.1 | 3.5 | 3.1 | 3.5 |
| In-center revenue | 28.3 | 29.1 | 28.5 | 29.5 |
| Total center revenue | 98.6 | 98.1 | 98.5 | 98.2 |
| Other revenue | 1.4 | 1.9 | 1.5 | 1.8 |
| Total revenue | 100.0 | 100.0 | 100.0 | 100.0 |
| Operating expenses | | | | |
| Center operations | 60.6 | 58.9 | 61.1 | 58.6 |
| Advertising and marketing | 2.9 | 3.5 | 3.4 | 4.3 |
| General and administrative | 5.5 | 5.5 | 5.6 | 5.7 |
| Other operating | 2.3 | 2.4 | 2.3 | 2.3 |
| Depreciation and amortization | 10.7 | 9.0 | 10.7 | 9.0 |
| Total operating expenses | 82.0 | 79.3 | 83.1 | 79.9 |
| Income from operations | 18.0 | 20.7 | 16.9 | 20.1 |
| Other income (expense) | | | | |
| Interest expense, net | (3.7) | (3.6) | (3.7) | (3.7) |
| Equity in earnings of affiliate | 0.2 | 0.2 | 0.2 | 0.2 |
| Total other income (expense) | (3.5) | (3.4) | (3.5) | (3.5) |
| Income before income taxes | 14.5 | 17.3 | 13.4 | 16.6 |
| Provision for income taxes | 5.9 | 7.0 | 5.4 | 6.7 |
| Net income | 8.6% | 10.3% | 8.0% | 9.9% |
| Other financial and operating data: | | | | |
| Comparable center revenue growth 13 month (1) | (4.4)% | 3.3% | (3.6)% | 3.8% |
| Comparable center revenue growth 37 month (1) | (9.0)% | (2.0)% | (8.4)% | (1.9)% |
| Average revenue per membership | \$ 354 | \$ 361 | \$ 706 | \$ 724 |
| Average in-center revenue per membership | \$ 102 | \$ 107 | \$ 204 | \$ 218 |
| EBITDA (in thousands) | \$ 61,237 | \$ 57,394 | \$ 116,141 | \$ 110,323 |

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| | | | | |
|--|-----------|------------|-----------|------------|
| EBITDA margin | 28.8% | 29.8% | 27.7% | 29.3% |
| Capital expenditures (in thousands) | \$ 42,825 | \$ 135,092 | \$ 91,725 | \$ 235,577 |
| Centers open at end of period | 84 | 74 | 84 | 74 |
| Number of memberships at end of period | 608,281 | 547,497 | 608,281 | 547,497 |
| Total center square footage at end of period | | | | |
| (2) | 8,445,689 | 7,298,299 | 8,445,689 | 7,298,299 |

(1) Membership dues, enrollment fees and in-center revenue for a center are included in *comparable center revenue growth 13 month* beginning on the first day of the thirteenth full calendar month of the center's operation and are included in *comparable center revenue growth 37 month* beginning on the first day of the thirty-seventh full calendar month of the center's operation, at which time it is considered a mature center.

(2) The square footage presented in this table reflects fitness square footage which is the best metric for the efficiencies of a facility. In a few of our centers,

we sublease space to third parties who operate our pro shop, salon or climbing wall or to hospitals or chiropractors that use the space to provide physical therapy. The square footage figures include those subleased areas. The square footage figures exclude areas used for tennis courts and outdoor swimming pools. These figures are approximations.

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Three Months Ended June 30, 2009, Compared to Three Months Ended June 30, 2008

Total revenue. Total revenue increased \$20.1 million, or 10.5%, to \$212.5 million for the three months ended June 30, 2009, from \$192.4 million for the three months ended June 30, 2008.

Total center revenue grew \$20.9 million, or 11.1%, to \$209.6 million for the three months ended June 30, 2009, from \$188.7 million for the three months ended June 30, 2008. Of the \$20.9 million increase in total center revenue, 80.0% was from membership dues, which increased \$16.7 million, or 13.3%, due to increased memberships at new centers, junior membership programs and increased sales of 26-and-under memberships. Our number of memberships increased 11.1% to 608,281 at June 30, 2009 from 547,497 at June 30, 2008.

20.5% was from in-center revenue, which increased \$4.3 million primarily as a result of increased sales of our LifeCafe products and services and personal training. Average in-center revenue per membership decreased from \$107 for the three months ended June 30, 2008 to \$102 for the three months ended June 30, 2009. We began to see slower in-center revenue growth in the second half of 2008 and first half of 2009 due to the slower economy.

(0.5)% was from enrollment fees, which are deferred until a center opens and recognized on a straight-line basis over 30 months, our estimated average life of a membership. Since the fourth quarter of 2008, the estimated average life of a membership has been 30 months. For the second and third quarters of 2008, it was 33 months, and for the first quarter of 2008 and prior, it was 36 months. Enrollment fees decreased by \$0.1 million for the three months ended June 30, 2009 to \$6.5 million. In 2008 and the first half of 2009, we lowered our enrollment fees to stimulate new membership demand.

Other revenue decreased \$0.8 million, or 20.6%, to \$2.9 million for the three months ended June 30, 2009, which was primarily due to lower media sales.

Center operations expenses. Center operations expenses totaled \$128.9 million, or 61.5% of total center revenue (or 60.6% of total revenue), for the three months ended June 30, 2009 compared to \$113.3 million, or 60.0% of total center revenue (or 58.9% of total revenue), for the three months ended June 30, 2008. This \$15.6 million increase primarily consisted of an increase of \$6.4 million in occupancy-related costs, including utilities, real estate taxes and rent on leased centers, \$3.5 million in additional payroll-related costs to support increased memberships at new centers and increases in membership acquisition costs and an increase in expenses to support in-center products and services. Center rent expense totaled \$9.9 million for the three months ended June 30, 2009 and \$5.3 million for the three months ended June 30, 2008. This \$4.6 million increase is primarily a result of the six sale-leaseback transactions that we entered into during the second half of 2008.

Advertising and marketing expenses. Advertising and marketing expenses were \$6.1 million, or 2.9% of total revenue, for the three months ended June 30, 2009, compared to \$6.8 million, or 3.5% of total revenue, for the three months ended June 30, 2008. These expenses decreased primarily due to less presale activity and more targeted and more market-specific marketing campaigns.

General and administrative expenses. General and administrative expenses were \$11.8 million, or 5.5% of total revenue, for the three months ended June 30, 2009, compared to \$10.6 million, or 5.5% of total revenue, for the three months ended June 30, 2008. This \$1.2 million increase was primarily due to increased costs to support the growth in memberships and the number of centers, unabsorbed real estate and development overhead and employee separation costs.

Other operating expenses. Other operating expenses were \$4.9 million for the three months ended June 30, 2009, compared to \$4.7 million for the three months ended June 30, 2008. This increase is primarily a result of start-up costs associated with the expansion of our corporate wellness businesses and losses on the disposition of assets, which were partially offset by a gain on the sale of land held for sale.

Depreciation and amortization. Depreciation and amortization was \$22.6 million for the three months ended June 30, 2009, compared to \$17.2 million for the three months ended June 30, 2008. This \$5.4 million increase was due

primarily to depreciation on our new centers opened in 2008 and the first three months of 2009 and the remodels of acquired clubs completed in 2008.

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Interest expense, net. Interest expense, net of interest income, was \$7.9 million for the three months ended June 30, 2009, compared to \$6.9 million for the three months ended June 30, 2008. This \$1.0 million increase was primarily the result of decreased capitalized interest on construction projects.

Provision for income taxes. The provision for income taxes was \$12.5 million for the three months ended June 30, 2009, compared to \$13.5 million for the three months ended June 30, 2008. This \$1.0 million decrease was due to a decrease in income before income taxes of \$2.6 million. The effective income tax rate for the three months ended June 30, 2009 was 40.6% compared to 40.5% for the three months ended June 30, 2008.

Net income. As a result of the factors described above, net income was \$18.3 million, or 8.6% of total revenue, for the three months ended June 30, 2009, compared to \$19.8 million, or 10.3% of total revenue, for the three months ended June 30, 2008.

Six Months Ended June 30, 2009, Compared to Six Months Ended June 30, 2008

Total revenue. Total revenue increased \$42.1 million, or 11.2%, to \$419.0 million for the six months ended June 30, 2009, from \$376.9 million for the six months ended June 30, 2008.

Total center revenue grew \$42.6 million, or 11.5%, to \$412.8 million for the six months ended June 30, 2009, from \$370.2 million for the six months ended June 30, 2008. Of the \$42.6 million increase in total center revenue, 80.9% was from membership dues, which increased \$34.5 million, or 14.0%, due to increased memberships at new centers, junior membership programs and increased sales of 26-and-under memberships. Our number of memberships increased 11.1% to 608,281 at June 30, 2009 from 547,497 at June 30, 2008.

19.5% was from in-center revenue, which increased \$8.3 million primarily as a result of increased sales of our LifeCafe products and services and personal training. Average in-center revenue per membership decreased from \$218 for the six months ended June 30, 2008 to \$204 for the six months ended June 30, 2009. We began to see slower in-center revenue growth in the second half of 2008 and first half of 2009 due to the slower economy.

(0.4)% was from enrollment fees, which are deferred until a center opens and recognized on a straight-line basis over 30 months, our estimated average life of a membership. Since the fourth quarter of 2008, the estimated average life of a membership has been 30 months. For the second and third quarters of 2008, it was 33 months, and for the first quarter of 2008 and prior, it was 36 months. Enrollment fees decreased by \$0.2 million for the six months ended June 30, 2009 to \$13.0 million. In 2008 and the first half of 2009, we lowered our enrollment fees to stimulate new membership demand.

Other revenue decreased \$0.5 million, or 7.5%, to \$6.2 million for the six months ended June 30, 2009, which was primarily due to lower media sales.

Center operations expenses. Center operations expenses totaled \$255.8 million, or 62.0% of total center revenue (or 61.1% of total revenue), for the six months ended June 30, 2009 compared to \$220.8 million, or 59.7% of total center revenue (or 58.6% of total revenue), for the six months ended June 30, 2008. This \$35.0 million increase primarily consisted of an increase of \$13.9 million in occupancy-related costs, including utilities, real estate taxes and rent on leased centers, \$9.9 million in additional payroll-related costs to support increased memberships at new centers and increases in membership acquisition costs and an increase in expenses to support in-center products and services. Center rent expense totaled \$19.8 million for the six months ended June 30, 2009 and \$10.4 million for the six months ended June 30, 2008. This \$9.4 million increase is primarily a result of the six sale-leaseback transactions that we entered into during the second half of 2008.

Advertising and marketing expenses. Advertising and marketing expenses were \$14.4 million, or 3.4% of total revenue, for the six months ended June 30, 2009, compared to \$16.3 million, or 4.3% of total revenue, for the six months ended June 30, 2008. These expenses decreased primarily due to less presale activity and more targeted and more market-specific marketing campaigns.

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General and administrative expenses. General and administrative expenses were \$23.5 million, or 5.6% of total revenue, for the six months ended June 30, 2009, compared to \$21.3 million, or 5.7% of total revenue, for the six months ended June 30, 2008. This \$2.2 million increase was primarily due to increased costs to support the growth in memberships and the number of centers and unabsorbed real estate and development overhead. These expenses decreased as a percentage of revenue primarily due to increased efficiencies and productivity improvements.

Other operating expenses. Other operating expenses were \$9.8 million for the six months ended June 30, 2009, compared to \$8.8 million for the six months ended June 30, 2008. This increase is primarily a result of start-up costs associated with the expansion of our corporate wellness businesses and losses on the disposition of assets.

Depreciation and amortization. Depreciation and amortization was \$44.7 million for the six months ended June 30, 2009, compared to \$33.8 million for the six months ended June 30, 2008. This \$10.9 million increase was due primarily to depreciation on our new centers opened in 2008 and the first half of 2009 and the remodels of acquired clubs completed in 2008.

Interest expense, net. Interest expense, net of interest income, was \$15.4 million for the six months ended June 30, 2009, compared to \$14.1 million for the six months ended June 30, 2008. This \$1.3 million increase was primarily the result of decreased capitalized interest on construction projects.

Provision for income taxes. The provision for income taxes was \$22.7 million for the six months ended June 30, 2009, compared to \$25.2 million for the six months ended June 30, 2008. This \$2.5 million decrease was due to a decrease in income before income taxes of \$6.3 million. The effective income tax rate for the six months ended June 30, 2009 was 40.5% compared to 40.4% for the six months ended June 30, 2008.

Net income. As a result of the factors described above, net income was \$33.4 million, or 8.0% of total revenue, for the six months ended June 30, 2009, compared to \$37.2 million, or 9.9% of total revenue, for the six months ended June 30, 2008.

Liquidity and Capital Resources

Liquidity

Historically, we have satisfied our liquidity needs through various debt and sale-leaseback arrangements, sales of equity and cash flow provided by operations. Principal liquidity needs have included the development of new centers, debt service requirements and expenditures necessary to maintain and update our existing centers and associated fitness equipment. We believe that we can satisfy our near-term debt service obligations and capital expenditure requirements with cash flow from operations. We believe that we can satisfy our longer-term debt service obligations and capital expenditure requirements with cash flow from operations, by the extension of the terms of or refinancing our existing debt facilities, through sale-leaseback transactions and by continuing to raise long-term debt or equity capital, although there can be no assurance that such actions can or will be completed. Our business model operates with negative working capital because we carry minimal accounts receivable due to our ability to have monthly membership dues paid by electronic draft, we defer enrollment fee revenue and we fund the construction of our new centers under standard arrangements with our vendors that are paid with proceeds from long-term debt.

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The following table summarizes our capital structure as of June 30, 2009 and December 31, 2008 (in thousands).

| | June 30, 2009 | December 31, 2008 |
|--------------------------------------|--------------------------|----------------------------------|
| Debt | | |
| Long-term debt | \$ 695,401 | \$ 702,569 |
| Current maturities of long-term debt | 11,945 | 10,335 |
| Total debt | 707,346 | 712,904 |
| Shareholders' Equity | | |
| Common stock | 825 | 793 |
| Additional paid-in capital | 389,462 | 385,095 |
| Retained earnings | 305,085 | 271,711 |
| Accumulated other comprehensive loss | (3,851) | (4,698) |
| Total shareholders' equity | 691,521 | 652,901 |
| Total capitalization | \$ 1,398,867 | \$ 1,365,805 |

Debt highlights, as of June 30, 2009 and December 31, 2008:

| | June 30, 2009 | December 31, 2008 |
|---|--------------------------|----------------------------------|
| Fixed-rate debt as a percent of total debt | 55.2% | 54.6% |
| Weighted-average annual interest rate of total debt | 3.9% | 4.5% |
| Total debt (net of cash) as a percent of total capitalization (total debt (net of cash) and total shareholders' equity) | 50.2% | 51.8% |
| Cash provided by operating activities (trailing twelve months) as a percent of total debt | 24.8% | 25.7% |

Operating Activities

As of June 30, 2009, we had total cash and cash equivalents of \$10.8 million. We also had \$51.5 million available under the existing terms of our revolving credit facility as of June 30, 2009.

Net cash provided by operating activities was \$98.3 million for the six months ended June 30, 2009 compared to \$105.7 million for the six months ended June 30, 2008. This reduction of \$7.4 million is due primarily due to tax payment timing and the level of bonus depreciation deduction available. The first half of 2008 benefited from a \$5.8 million 2007 tax receivable which was applied to 2008 estimated tax and also benefited from bonus depreciation deductions created by the large volume of 2008 asset additions.

Investing Activities

Investing activities consist primarily of purchasing real property, constructing new centers and purchasing new fitness equipment. In addition, we invest in capital expenditures to maintain and update our existing centers. We plan to finance the purchase of our property and equipment in the near-term through cash flow from operations. We plan to finance the purchase of our property and equipment in the longer-term through cash flow from operations, by the extension of the terms of or refinancing our existing debt facilities, through sale-leaseback transactions and by continuing to raise long-term debt or equity capital.

Net cash used in investing activities was \$90.8 million for the six months ended June 30, 2009, compared to \$249.3 million for the six months ended June 30, 2008. The decrease of \$158.5 million was primarily due to the

reduced number of centers we currently plan to open.

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Our capital expenditures were as follows (in thousands):

| | For the Six Months Ended June 30, | |
|---|--|-------------------|
| | 2009 | 2008 |
| Purchases of property and equipment | \$ 91,725 | \$ 235,577 |
| Non-cash property and equipment financed through capital lease obligations | | 12,121 |
| Changes in construction accounts payable and accounts payable related to property and equipment | (40,855) | 17,999 |
| Non-cash share-based compensation capitalized to projects under development | 320 | 443 |
| Total capital expenditures | \$ 51,190 | \$ 266,140 |

The following schedule reflects capital expenditures by type of expenditure for the six months ended June 30, 2009 (in thousands):

| | |
|---|------------------|
| New center building and construction on clubs opened in 2008 and 2009 | \$ 26,472 |
| New center building and construction on clubs to be opened in 2010 and beyond | 9,086 |
| Updating existing centers and corporate infrastructure | 15,632 |
| Total capital expenditures | \$ 51,190 |

At July 31, 2009, we had purchased the real property for two and entered into a ground lease for one of the three large format centers we plan to open in 2010, and we had purchased real property for four large format centers that we plan to open after 2010. Construction in progress, including land purchased for future development, totaled \$93.5 million at June 30, 2009 and \$257.1 million at June 30, 2008.

We expect our cash outlays for capital expenditures to be approximately \$125 to \$150 million in 2009, including approximately \$33 to \$58 million in the remaining six months of 2009. Of this approximately \$33 to \$58 million, we expect to incur approximately \$20 to \$40 million for new center construction and approximately \$13 to \$18 million for the updating of existing centers and corporate infrastructure. We plan to fund these capital expenditures primarily with cash flow from operations.

Financing Activities

Net cash used in financing activities was \$7.5 million for the six months ended June 30, 2009, compared to net cash provided by financing activities of \$142.0 million for the six months ended June 30, 2008. The decrease of \$149.5 million was primarily due to payments made on our revolving credit facility.

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Long-term debt consists of the following (in thousands):

| | June 30, 2009 | December 31, 2008 |
|---|--------------------------|----------------------------------|
| Term notes payable to insurance company, monthly interest and principal payments totaling \$1,273 including interest at 8.25% to June 2011 | \$ 108,736 | \$ 111,812 |
| Revolving credit facility, interest only due monthly at interest rates ranging from LIBOR plus 0.625% to 1.50% or base plus 0.0%, facility expires May 2012 | 407,800 | 414,600 |
| Term notes payable with monthly interest and principal payments totaling \$632 including interest at 6.03% to February 2017 | 102,086 | 102,752 |
| Other | 69,551 | 64,056 |
| Total debt (excluding obligations under capital leases) | 688,173 | 693,220 |
| Obligations under capital leases | 19,173 | 19,684 |
| Total debt | 707,346 | 712,904 |
| Less current maturities | 11,945 | 10,335 |
| Total long-term debt | \$ 695,401 | \$ 702,569 |

Revolving Credit Facility

The amount of our revolving credit facility is \$470.0 million. We may increase the total amount of the facility up to \$600.0 million through further exercise of the accordion feature by us if one or more lenders commit the additional \$130.0 million. As of June 30, 2009, \$407.8 million was outstanding on the facility, plus \$10.7 million related to letters of credit, leaving \$51.5 million available for additional borrowing under the existing terms of the facility. The weighted average interest rate and debt outstanding under the revolving credit facility for the six months ended June 30, 2009 was 2.2% and \$387.5 million, respectively. The weighted average interest rate and debt outstanding under the revolving credit facility for the six months ended June 30, 2008 was 4.6% and \$351.0 million, respectively.

New Long-Term Debt

In March 2009, we financed one Minnesota center using an obligation bearing interest at a fixed rate of 6.25% amortized over a 15-year period. This obligation is due in full in March 2014. As security for the obligation, we have granted a mortgage on this center. As of June 30, 2009, \$4.8 million was outstanding with respect to this obligation. In May 2009, we financed one Minnesota center using an obligation bearing interest at a rate of 7.10%, to be reset in May 2014 and May 2019 using the five-year LIBOR swap rate plus 4.50%, with a 6.00% floor, and amortized over a 20-year period. This obligation is due in full in May 2024. As security for the obligation, we have granted a mortgage on this center. As of June 30, 2009, \$3.0 million was outstanding with respect to this obligation.

Table of Contents*Debt Covenants*

We are in compliance in all material respects with all restrictive and financial covenants under our various credit facilities as of June 30, 2009.

Our primary financial covenants under our revolving credit facility are:

| Covenant | Requirement | Actual as of June 30, 2009 | Actual as of December 31, 2008 |
|------------------------------------|------------------------------|---|---|
| Total Consolidated Debt to EBITDAR | Not more than 4.0 to 1.0 | 3.52 to 1.0 | 3.51 to 1.0 |
| Senior Debt to EBITDA | Not more than 3.25 to 1.0 | 2.14 to 1.0 | 2.22 to 1.0 |
| Fixed Charge Coverage Ratio | Not less than 1.60 | 2.65 to 1.0 | 3.16 to 1.0 |

The formulas for these covenants are specifically defined in the revolving credit facility and include, among other things, an add back of share-based compensation expense to EBITDAR and EBITDA.

The Fixed Charge Coverage Ratio decrease of 0.51 from December 31, 2008 to June 30, 2009 was primarily due to additional rent expense from the six sale-leaseback transactions that we entered into during the second half of 2008.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We invest our excess cash in highly liquid short-term investments. These investments are not held for trading or other speculative purposes. Changes in interest rates affect the investment income we earn on our cash and cash equivalents and our interest expense on floating-rate indebtedness and therefore, impact our consolidated cash flows and consolidated results of operations. As of June 30, 2009 and December 31, 2008, our net floating-rate indebtedness was approximately \$322.8 million and \$323.8 million, respectively. If our interest rates on our floating-rate indebtedness were to have increased by 100 basis points during the six months ended June 30, 2009, our interest costs would have increased by approximately \$1.5 million. If short-term interest rates were to have increased by 100 basis points during the six months ended June 30, 2009, our interest income from cash equivalents would have increased by less than \$0.1 million. These amounts are determined by considering the impact of the hypothetical interest rates on our floating-rate indebtedness and cash equivalents balances at June 30, 2009.

Item 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)). Based on this evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including the principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION**ITEM 1. LEGAL PROCEEDINGS**

Not applicable.

ITEM 1A. RISK FACTORS

Not applicable.

Table of Contents**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Issuer Purchases of Equity Securities in Second Quarter 2009**

There were no issuer purchases of equity securities in the second quarter of 2009. In June 2006, our Board of Directors authorized the repurchase of 500,000 shares of our common stock from time to time in the open market or otherwise for the primary purpose of offsetting the dilutive effect of shares issued pursuant to our Employee Stock Purchase Plan.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the Annual Meeting of Shareholders held on April 23, 2009, the shareholders voted on the following:

1. Proposal to elect a board of seven directors, to serve until the next annual meeting of shareholders or until their successors have been duly elected and qualified. The following directors were elected based on the votes listed below:

| | Nominee | For | Withheld |
|-----------------------|----------------|------------|-----------------|
| Bahram Akradi | | 31,958,476 | 2,787,898 |
| Giles H. Bateman | | 32,973,848 | 1,772,526 |
| Guy C. Jackson | | 31,388,639 | 3,357,735 |
| Martha A. Morfitt | | 33,940,307 | 806,067 |
| John B. Richards | | 34,485,847 | 260,527 |
| Joseph S. Vassalluzzo | | 34,482,883 | 263,491 |

2. Proposal to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2009. The proposal passed on a vote of 34,578,219 in favor, 66,992 against, 101,163 abstentions and no broker non-votes.

3. Proposal to approve the amendment to our Amended and Restated Articles of Incorporation to increase the authorized shares of common stock from 50,000,000 shares to 75,000,000 shares. The proposal passed on a vote of 32,306,686 in favor, 2,430,474 against, 9,214 abstentions and no broker non-votes.

4. Proposal to approve the amendment to our Amended and Restated 2004 Long-Term Incentive Plan to increase the number of shares available for issuance under the plan from 3,500,000 to 5,250,000